

THE EUROPEAN COMMISSION'S EVALUATIONS ON ITALY'S MACROECONOMIC IMBALANCES. BETWEEN THE FLEXIBILITY GRANTED AND THE DESIRED RELIABILITY

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Abstract

The European economic governance reform of 2011 (the so-called six pack) has placed a greater emphasis on macroeconomic surveillance, through the introduction of mechanisms that are both preventative and corrective, adopted from the procedures which have already been applied for public finance with the PSC. In fact, following the financial crisis of 2008, the link between public finances and the complex economic situation was highlighted.

In this perspective, the Macroeconomic Imbalances Procedure also includes the possibility that some Member States with excessive macroeconomic imbalances are subjected to an in-depth review (*In Depth Review* - IDR) aimed at implementing the re-entry measures recommended by the Council.

With regard to Italy, the final Report of the Commission within the MIP framework indicates, besides the high level of debt and low competitiveness, some elements of weakness which undermine the path to rehabilitation and development of the country.

The study aims to retrace the main observations which the European Commission has expressed in the Report of November 2014 in order to consider which reforms have been carried out and what is the gap between the re-entry path recommended by the European institution and the actions of the Italian government.

The analysis of the Italian case emphasises that the economic evaluations of European institutions are necessarily conditioned by the national and European political context. In fact, the credibility of the first conditions the granting of greater flexibility in the application of the rules. Simultaneously, an analogous conditioning derives from political interactions between the rigorous front and its opponents.

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1. Introduction

The difficulties encountered in the imposition of a unitary guide of financial measures for Member States have led to the expansion and deepening of the multilateral surveillance until, where necessary, the direction and the taking of economic policy decisions are reached, pursuant to Art.121Tfue, on the basis of which, the economic policies of Member States represent a "matter of common interest".

In this context, the so-called six pack introduced the Macroeconomic Imbalances procedure (MIP), aimed at the prevention and the correction of macroeconomic imbalances (see governance dossier).

Through MIP, the Commission has recently identified 9 States of the European Monetary Union which have excessive macroeconomic imbalances: Belgium, Germany, Ireland, Spain, France, Italy, Netherlands, Slovenia and Finland.

In the case of Italy, similar to Slovenia, the existence of excessive imbalances which require enhanced monitoring and the adoption of specific re-entry measures were found.

In particular, the European Commission identified an important element of imbalance in the high debt and weak competitiveness of the country.

The article, on the basis of observations made by the Commission in the last report of November 2014, aims to reconstruct and analyse the address of the financial political direction adopted by the government, trying to highlight the link

between the method of application of the rules of fiscal co-ordination and the reliability of policies put in place by the State.

The objective of this study is to demonstrate that the application of the somewhat flexible fiscal discipline depends not only on economic assessments but also on assessments of a political nature.

Reliance upon a government's political direction may depend on the activation of infringement procedures, or the concession of extra time to reduce imbalances.

It is, therefore, to set up a kind of directly proportional relationship between the margins of sovereignty remaining to the State and its government's ability to pursue its development objectives and sound public finance. The margins of fiscal sovereignty shrink in proportion to the inability of a State to govern its own economy and finances, provoking spill-over effects for the community.

This study begins with the analysis of the Macroeconomic Imbalances Procedure (MIP) (section 2 and 3) and moves forward to focus its attention on the main weaknesses highlighted by the Commission in key sectors of the country. The observations of the Commission shall be considered for each sector on the one hand while on the other, the actions taken by the Italian government (sections 4, 5, 6).

The analysis will conclude that most of the reforms undertaken can only be assessed in the long-term, once their effects have been produced. It, therefore, discusses the granting, alongside a flexibility for relevant factors, of exceptional events and the launching of structural reforms¹; even a temporal flexibility, consistent with the actual unfolding of reforms (reg. EU, no. 1176, art. 8, paragraph 2).

Compared to the latter type of flexibility, the political credibility and the supranational political dynamics of the Italian government will prove crucial when faced with an anti-rigorous front in the early stages (section 7).

¹ See Art. 2, par.1 bis reg.1467/97; 1466/1997, article 2, par. 2; art. 5, par. 1, letter c reg. EU no. 1466/1997.

2. The Macroeconomic Imbalances Procedure (MIP)

The reform of European economic governance in 2011 stressed the importance of macroeconomic surveillance, introducing both preventative and corrective mechanisms.

This helps not only for a deeper surveillance in the cases of States facing situations of financial instability, but now is also extended to include monitoring and correction of macroeconomic imbalances (reg. EU 1174/2011 and 1175/2011).

The range of macroeconomic surveillance is not limited to Eurozone countries, but includes the entire European Union, although different levels of co-ordination are provided for within the two zones.

The procedure for macroeconomic imbalances, based on Art.121Tfue, paragraph 2, provides for the monitoring of economic factors whose values, in the financial crisis of 2008, were identified as an early warning of this crisis.

The alert mechanism of the Macroeconomic Imbalances Procedure is based on a series of macroeconomic indicators whose value is shown as a "scoreboard" together with the respective threshold value beyond which presents a potential imbalance.

The scoreboard is defined and publicised by the European Commission on the basis of Article 4 of (EU) regulation no. 1176/2011.

In the Alert Mechanism Report of February 2012, the scoreboard consisted of ten indicators covering the entire scope of enforcement of macroeconomic surveillance as defined by Article 4, paragraph 3, of (EU) regulation no. 1176/2011². Although this

² See (EU) Regulation no. 1176/2011 of the European Parliament and of the Council of 16th November, 2011, on the prevention and correction of macroeconomic imbalances, art. 4, 3 "The scoreboard shall, inter alia, encompass indicators which are useful in the early identification of: (a) internal imbalances, including those that can arise from public and private indebtedness; financial and asset market developments, including housing; the evolution of private sector credit flow; and the evolution of unemployment; (b) external imbalances, including those that can arise from the evolution of current account and net investment positions of Member States; real effective exchange rates; export market shares; changes in price and cost developments; and non-price competitiveness, taking into account the different components of productivity. 4. In undertaking its economic reading of the scoreboard in the alert mechanism, the Commission shall pay close attention to developments in the real economy, including economic growth, employment and unemployment performance,

first set of indicators represented many financial aspects (e.g. the flow of credit to the private sector, public and private sector debt) the European Parliament and the Council have supported the European Commission's proposal of adding a further indicator intended to show the reciprocal links between the actual economy and the financial sector³.

The procedure is based on an Alert Mechanism which identifies, on the basis of the Scoreboard, in which Member States there are indications of potential emerging macroeconomic imbalances that may require further examination.

The framework of these indicators, accompanied by an economic analysis, is presented in an Annual Report which is usually presented in the month of November, the Alert Mechanism Report, which sets the starting point of the annual cycle of the procedure. The conclusions of the Alert Mechanism Report are examined by the Council of the European Union and the Eurogroup. The report identifies those Member States which are at risk of macroeconomic imbalance and which are expected to be subjected to a more detailed analysis (*In Depth Review* - IDR).

Simultaneously, as is provided for in the excessive deficit procedure, in case serious imbalances are revealed, it is up to the Council to declare their existence and recommend that the relevant State adopts specific measures within a specified period; the Council also verifies whether the Corrective Action Plan presented by the State is adequate, in which case it shall adopt a recommendation for setting out the actions and deadlines for its implementation, as indicated in the Plan.

nominal and real convergence inside and outside the euro area, productivity developments and its relevant drivers such as research and development and foreign and domestic investment, as well as sectorial developments including energy, which affect GDP and current account performance. The scoreboard shall also include indicative thresholds for the indicators, to serve as alert levels. The choice of indicators and thresholds shall be conducive towards promoting competitiveness in the Union".

³ See, European Commission, Report from the Commission to the European Parliament, the Council, The European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank on the Alert Mechanism Report 2013, COM (2012) 751 final, 28 November 2012; European Commission, Scoreboard for the surveillance of macroeconomic imbalances, European Economy, Occasional Papers no.92, February 2012.

Otherwise, if the corrective action planned by the State is considered to be insufficient, the Council recommends the drafting of a new plan which, if assessed as being inadequate again, exposes the relevant State to the imposition of a penalty equivalent to 0.1% of GDP.

The procedure continues with the monitoring of the implementation measures contained in the plan and ends with the return to imbalances.

The possibility that the procedure is suspended in cases where the imbalance persists is also expected, despite the implementation of all the measures in the Corrective Action Plan.

Conversely, if the State has not followed corrective measures, the Council may impose an interest-bearing deposit of up to 0.1% of GDP, together with the issuing of recommendations of new terms for the adoption of corrective measures; in case of continued non-compliance by the State, the deposit changes into a fine.

For the Eurozone, the Macroeconomic Imbalance Procedure (MIP) constitutes a further strengthening of the co-ordination of fiscal policies, complementing and indirectly strengthening the financial co-ordination, given that the financial situation of a country is the most obvious manifestation, and the result of economic policies that are put in place, but without providing a complete picture.

3. The Commission's observations relative to Italy's macroeconomic imbalances

Pursuant to EU Reg. no. 1176/2011, the country-specific recommendations, approved by the Council on the basis of the European Commission's assessment on the macroeconomic situation and the budget of the country, indicate how to intervene in order to overcome macroeconomic imbalances.

Italy is subject to enhanced monitoring because its imbalances were considered to be excessive, equal to what was provided for in the case of Slovenia and similarly, to what was provided for in the case of France and Spain which have macroeconomic imbalances that are not really excessive but "serious".

Enhanced monitoring is carried out through a more detailed formulation of the Council's recommendations, indicating the reforms to be adopted and the time limits for their implementation, and in the preparation of two specific interim reports from the Commission.

In particular, the European Commission presented the third Alert Mechanism Report on the 13th November, 2013, on the basis of which, those countries which should be subjected to an in-depth analysis relative to the existence of macroeconomic⁴ imbalances were identified.

With regard to Italy, the European Commission's in-depth analysis published on the 5th March, 2014, has highlighted the risks associated with the high level of public debt and the weak external competitiveness, both deriving from low growth in productivity.

Based on the Stability Programme and the National Reform Programme presented by Italy in April 2014, the European Commission proposed eight specific recommendations to Italy in June 2014, subsequently adopted by the Council of the European Union.

At the same time, the European Commission commenced the monitoring of progress made by member countries in the adoption of the policy measures that can contribute to the reduction of imbalances.

An initial monitoring mission commenced in Italy on the days of the 15th - 17th September, 2014, and the results were presented in the report published on the 10th November which will be updated at the beginning of 2015 on the basis of results of a second mission.

The report was prepared on the basis of the contents of the Update to the Economic and Financial Document (DEF) 2014 and successive modifications made through the Report to Parliament of the end of October 2014.

The Commission conducts assessments largely attributable to three areas: 1) Measures related to public finances and public debt sustainability; 2) Measures related to productivity growth

⁴ See European Commission, *Alert Mechanism Report 2014*, COM (2013) 790 final, 13 November 2013.

and external competitiveness; 3) Measures related to institutional capacity to implement reforms.

4. Measures related to public finances and public debt sustainability

In particular, the observations relative to public finance show that the high public debt represents, for various reasons, a heavy negative element for the country's growth and development.

In the first place, a high level of debt necessitates a high level of taxation to maintain it; secondly, costs resulting from the payment of interest are very high; third, a country with high debt is exposed to the volatility of financial markets and, therefore, at the risk of re-financing.

For these reasons, the reduction in the stock of public debt is the main priority for Italy. This notwithstanding that, fiscal balances, both in nominal and structural terms took a turn for the worse in October 2014 with respect to the previous values indicated in the Economic and Financial Decisions (DEF) presented in April 2014: it is expected that the Deficit/GDP ratio is equal to 2.6% and that the Debt/GDP ratio shall reach the maximum value in 2015, equal to 133% to then decrease in 2016 onwards, although at a slower rhythm than envisaged in the Stability Programme 2014.

In this respect, in the recommendations relative to the National Reform Programme and the Stability Programme the need for a Minimum Linear Structural Adjustment (MLSA) of the structural deficit equal to 0.7 percentage points of GDP was already highlighted, to achieve the objectives of debt reduction after the 2013-2015⁵ transition period; subsequently, in view of the worsening economic conditions, in the Update of the Economic and Financial Document (DEF), expectations related to the

⁵ See Commission staff Working Document, Assessment of the 2014 National Reform Programme and Stability Programme for Italy, Accompanying the document. Recommendation for a Council Recommendation on Italy's 2014 National Reform Programme and delivering a Council opinion on Italy's 2014 Stability Programme, Brussels, 2.5.2014, Swd (2014) final; available at: http://ec.europa.eu/europe2020/pdf/csr2014/swd2014_italy_en.pdf.

necessary Minimum Linear Structural Adjustment increased to 0.9 percentage points of GDP⁶.

However, a Minimum Linear Structural Adjustment of 0.9 percentage points of GDP would lead to a correction of 2.2 percentage points of GDP to be in line with the forward-looking benchmark of 2017 in which the Debit/GDP ratio is set equal to 126%.

This would be a very severe correction which the Italian government appropriately believes is “neither feasible nor desirable”⁷, reserving the right to take advantage of the margins of flexibility in the current regulations of the Stability Growth Path (SGP) on the basis of the relevant factors characterising the current Italian financial situation⁸.

In particular, the measures announced in the Italian Stability Programme and National Reform Programme (NRP), to obtain an improvement in the public debt/GDP ratio, were aimed toward reviving the economy by accelerating the payments of outstanding debt on the part of the public authorities and above all, through a privatisation plan which, in the period 2014-2017, would bring a cash intake equal to 0.7% of the GDP.

In the Update to the DEF, forecasts for such a cash intake decreased to 0.4% of GDP, due to delays in operations previously announced but deferred due to unfavourable market conditions.

For these reasons, the privatisation of Poste Italiane (up to 40%) and ENAV (up to 49%) for example, has been postponed and could take place in 2015.

With regard to the extensive privatisation programme announced by the Italian government, the European Commission observed that other operations which could be implemented in the short-term are the sale of the Ministry of Economy and Finance's (MEF) stake in the holding STH which controls STMicroelectronics and possibly 5% of ENEL shares (out of the 31.24% owned by the MEF).

⁶ See, European Commission, *Italy – review of progress on policy measures relevant for the correction of macroeconomic imbalances*, Brussels, November 2014.

⁷ See Minister of Finance, Update to Economic and Financial Document, 2014, p.44 and table III.6.

⁸ On these issues, please refer to the comments already made in F. Nugnes, *Italian Government's Balanced Budget postponement*, 1 IJPL (2014).

At the same time, the Commission noted that the privatisation of the Company's export credit insurance (SACE) and CDP Networks, does not involve a significant amount distributed to the MEF in the form of super-dividends because it is made up of two companies under indirect control of the state through Cassa Depositi e Prestiti (CDP).

Unlike previous observations, the assessment on "The Rationalisation Programme for Local Public Enterprises" presented by the Spending Review Commissioner in August 2014, which may facilitate the privatisation of companies owned by local authorities⁹, has been very positive.

In particular, the Programme for the re-organisation of subsidiary companies presented by the Spending Review Commissioner which involves a reduction from 8000 to 1000, over a three year period, and the improvement of efficiency in order to have beneficial effects on public finance and on services offered.

The strategy of the re-organisation plan is divided into four points: a) reduce the scope of the subsidiaries within the area corresponding to the institutional goals pursued by the authorities¹⁰; b) introduce direct constraints on various forms of participation; c) enter a series of direct limits on public participation and accelerate the closure of non-operative Companies; d) favour the exploitation of economies of scale and therefore, the aggregation of public service undertakings to the network of economic importance in such a way that their catchment areas coincide with the Environmental Authorities (ATO).

These measures aimed at the rationalisation of the subsidiaries support the improvement of their performance. Thus, for example, the proposal to use standard costs in service contracts and in benchmarking analysis, or the proposal which enhances

⁹ See: http://revisionedellaspesa.gov.it/documenti/Programma_partecipate_locali_master_copy.pdf.

¹⁰ It is a provision already provided for in Art. 23, paragraph 27, of the Law 244/2007, but which, due to the vagueness with which it was made, has not found an effective implementation. The reform proposal provides that, the decision to maintain the involvement of local authorities in companies operating in sectors that are not strictly related to the institutional tasks of the authority is subject to screening from the Anti-trust Authority for Competition and the Market (AGCM).

transparency and greater information for the public as a form of control and stimulus for improvement.

Although the reduction of subsidiaries has been considered to be of fundamental importance by the European Commission for the purposes of improvement of public finance, in the Update to DEF it does not appear among the reforms undertaken on the recommendations of the Council of the 26th June, 2014.

Another fundamental step in the Report of the Commission relates to the new strategy of the spending review which is no longer based on the linear cuts imposed from above, but founded on the indication of expenditure cuts on the part of each Authority.

In particular, compared to the new method of spending review, the Commission believes that if on the one hand it is possible to increase the sense of participation and sharing of objectives, on the other there is the risk that this method is not effective and may compromise the effort to use the savings in public expenditure as a tool for economic growth.

According to the Commission, the uncertainty of the effects of the *spending review* endangers the fulfilment of some measures, such as for example, the reduction of the fiscal wedge (labour tax cost), which should be largely financed by the savings on expenditure.

On this point, the findings of the Commission lend themselves to a dual observation: one relating to a choice of method; the other relating to the probability that the risk of not being able to finance some measures with the savings derived from the spending review materialises.

With regard to the choice of method, it should be considered that in Italy the spending review has always followed a centralised top-down approach, in which decisions to reduce expenditure were imposed from above, with little contribution from public authorities.

Since Law No. 296/2006 the Ministry of Economy has been assigned the task of starting an extraordinary programme of analysis and assessment of expenditure, aimed at identifying "critical issues, options for the re-allocation of resources, possible strategies for improvement of achievable results with available

resources, in terms of quality and cost-effectiveness" (Law No. 296/2006)¹¹.

Also on the example of other jurisdictions, with Law No. 196 of 2009 (Art. 39) the experimentation which commenced in 2007 was institutionalised and then re-launched through the actions of the Monti Government, by Legislative Decree 95 of 2012¹².

In particular, the spending review was formally centred on the collaboration between the Ministry of Economy and Finance and the central authorities. This collaboration takes place within Nuclei of analysis and evaluation of expenditure, specifically set up with the purpose of monitoring the measures decided in the planning phase of the budget, verifying the degree of results against the objectives achieved.

However, in practice, the spending review has almost always occurred in a centralised manner.

An example in this respect was the Legislative Decree No. 95/2012, enacted into Law No. 135 of the 7th August, 2012, which

¹¹ The programme of analysis and evaluation of expenditure became permanent with the Finance Act of 2008 (Law No. 244 of 2007). The programme was entrusted to the Technical Commission for Public Finance with the support of the State Accounting Office. See the *Rapporto intermedio sulla revisione della spesa*, Rome, December 2007 and *La revisione della spesa pubblica. Rapporto 2008*, Rome, December 2008; *Rapporto sulla spesa delle amministrazioni centrali dello Stato*, Rome, 2009; see G. Pisauro, *La valutazione della spesa pubblica*, 7 Gior. Dir. Amm. 684 (2010); a reconstruction of spending review regulatory measures see; G. Mazzantini, *La lunga strada della spending review*, 12 Gior. Dir. Amm. 1163 (2012).

¹² See L. Fiorentino, *Oltre la straordinarietà, Il decreto "spending review"*, 12 Gior. Dir. Amm. 1163 (2012); G. Mazzantini, *La lunga strada della spending review*, cit. at 11; M. Macrì, *Il nuovo sistema di acquisti di beni e servizi*, 12 Gior. Dir. Amm. 1167 (2012); C. Lacava, *Le misure di razionalizzazione: l'organizzazione centrale e periferica dello Stato*, 12 Gior. Dir. Amm. 1172 (2012); S. Corsi, *La spesa nelle autonomie locali*, 12 Gior. Dir. Amm. 1179 (2012); N. Di Vivo, *La spesa sanitaria*, 12 Gior. Dir. Amm. 1185 (2012); D. Colaccino, *La dismissione e la razionalizzazione di partecipazioni societarie dello Stato*, 12 Gior. Dir. Amm. 1189 (2012); S. Screpanti, *La dismissione e la valorizzazione del patrimonio immobiliare pubblico*, 12 Gior. Dir. Amm. 1193 (2012); for a review of Legislative Decree No. 52/2012 see G. Rivosecchi, *Gli organi e le procedure di controllo*, 10 Gior. Dir. Amm. 917 (2012); a comparison between the measures adopted by other jurisdictions and the effects of the crisis on the government expenditure models has been elaborated by F. Di Mascio and A. Natalini, *La riduzione della spesa pubblica e la riforma amministrativa*, in G. Napolitano (ed.), *Uscire dalla crisi* (2012).

operated a spending review on various fronts¹³, but always following a logic of linear cuts in expenditure.

It proved to be an ineffective approach in terms of the quality of reduced expenditure.

The main weakness of the method has been identified in the lack of collaboration of the targeted Authorities and protagonists over the intervention measures. This lack of collaboration has been attributed to the lack of shared objectives established upstream of the spending review procedure¹⁴.

In fact, the containment of public expenditure occurred primarily through strict financial measures based on algebraic calculations, rather than on actual revisions and re-modelling, an element which has demotivated and taken away the responsibility from those responsible for public expenditure¹⁵.

Simultaneously, the review of second linear cuts produced a schism between the objectives pursued by the public authorities on the one hand, and those of the Ministry of Economy and Finance on the other. First of all, the planned targets are pursued through expenditure; secondly, the (reduction of) expenditure is the goal to be pursued¹⁶.

¹³ For a review of the provisions introduced by Legislative Decree No. 95/2012, enacted into law on the 7th August, 2012, no.135, see M. Macrì, *Il nuovo sistema di acquisti di beni e servizi*, cit. at 11; for a review on measures for staff reduction and re-structuring of central and peripheral structures of the State, see C. Lacava, *Le misure di razionalizzazione: organizzazione statale e periferica dello Stato*, cit. at 11, 1172; with regard to the interventions expenditure of local entities, S. Corsi, *La spesa nelle autonomie locali*, cit. p.1179; for measures relating to health expenditure see N. Di Vivo, *La spesa sanitaria*, cit. at 11, 1185; the provisions for the sale of company shares have been commented on by D. Colaccino, *La dismissione e al razionalizzazione di partecipazioni societarie dello Stato*, cit. at 12, 1189; the defeasance of public assets are commented on by S. Screpanti, *La dismissione e la valorizzazione del patrimonio immobiliare pubblico*, cit. at 12, 1193.

¹⁴ The importance of shared rules for the attainment of the objective in expenditure decisions is brought to light by M. Hallerberg, R. Strauch, J.von Hagen, *The design of fiscal rules and forms of governance in European Union countries*, Discussion Paper No. 150/2006, www.gesy.uni-mannheim.de

¹⁵ See C. Petrocchi, *Il trionfo della burocrazia della cifra*, in S. Cassese (ed.), *L'amministrazione pubblica in Italia* (1974); more recently see F. Battini, *L'amministrazione della spesa*, in S. Cassese (ed.), *Trattato di diritto amministrativo. Diritto amministrativo speciale* (2003).

¹⁶ See G. Amato, *Dalle regole di copertura al blocco degli impegni*, in R. Perez (ed.), *Le limitazioni amministrative alla spesa* (2003).

The synthesis of these two opposing views has been sought through a change in the methodological approach and in the adoption of administrative co-operation in which the Authorities involved may be more accountable.

In this sense, the positive experience of the Japanese system and even more so, the Canadian one, in which the role of public authorities in the address and in the management of public resources was crucial, confirms the validity of shared approaches¹⁷.

This aspect is especially relevant for a system such as the Italian one in which the formulation of the budget follows a bottom-up procedure where proposals from the Authorities are basic.

An approach based on shared objectives offers the possibility of exploiting the revision of public expenditure not only for a "State reduction", but for a re-distribution of its resources.

This re-distribution can occur through a re-organisation of structural and administrative procedures aimed at strengthening the implementation of the political and financial direction.

In this way, the expenditure evaluation and review process rises from austere accounting to become a tool capable of balancing budgetary constraints and re-distribution of resources¹⁸. In other words, finding a balance between the traditional principle of sound performance, which is already in the preceding Art. 97 of the Italian Constitution, and the "new" principles of budgetary equilibrium and sustainability of public debt.

More immediate is the observation related to the fact that the spending review's new strategy exposes the Italian

¹⁷ See Servizio bilancio del Senato, *La spending review nell'esperienza internazionale: una breve analisi*, no.57/2012; for the Canadian case see. J. Bourgon, *Program Review: The government of Canada's experience Eliminating the Deficit, 1994-1999. A Canadian Case Study*, Center for International Governance Innovation, www.cigionline.org; J. Ascoli, *Canada: Renewal of the Expenditure Management System, Strategic Reviews, and Lessons Learned*, presentation at the 77th Annual Meeting of OECD Senior Budget Officials Network on Performances and Results, 2011; for the Japanese methodology see H. Tanaka, *Review of "Program Review"*, in Japan, Report at the conference "Controlling Public Spending in Advanced Economies", 2011, Ministry of the Economy and Finance, Rome.

¹⁸ See L. Fiorentino, *Oltre la straordinarietà*, cit. at 12, 1161.

government to the risk of being unable to adopt the reforms announced.

In fact, in this case, the issue is related to the political choice of whether to bring about, or not, expenditure cuts suggested in the report of the spending review presented in August by Commissioner Cottarelli.

This is, therefore, an inherent choice for the functioning of government's political direction which, although strongly influenced by obligations coming from the European Union, remains at the national level.

In the case of Italy, expenditure cuts, contained in the 36 billion budgetary manoeuvre, amount to 15 billion and have been made using a method which is halfway between the shared objectives with public authorities and linear cuts imposed from above.

It remains indisputable that the Italian government has had to juggle between Scylla and Charybdis: on the one hand, the risk of worsening public finances, increasing the risk of EU sanctions; on the other, the risk of adopting expenditure cuts, an unpopular choice which increases the risk in terms of lower consensus on the part of the national electorate.

How effective this method of semi-linear cuts has been will already be known in the first months of 2015 because in March, if the announced reforms are not fulfilled or have not given the forecast results, the procedure for excessive macroeconomic imbalances will come into effect.

5 Weaknesses relative to growth in productivity and external competitiveness

A second area of concern for the Commission is related to the low growth in productivity which, in Italy's case, is consistent since the nineties and is caused by structural weakness in the country.

Some necessary reforms to alleviate the weaknesses of the system, one of which is related to the labour market, were highlighted.

On this point, the Italian Parliament passed an Enabling Law on the 3rd December 2014, the so-called Jobs Act, aimed at reducing the fragmentation of the labour market, of increasing

flexibility in output and creating a new system of social safety nets¹⁹.

In particular, the law empowers government to issue within six months the decree implementing new labour contracts with increased protection, through the establishment of a simplified Code of Discipline and the type of contracts, the adoption of new services and active labour market policies.

With regard to the contract with increased protection and the re-organisation of the type of contracts, the Enabling Law provides that the decrees should consider the coherence between the productive system and employment needs. In this perspective, by modifying Art. 18 of the Workers' Statute, the flexibility in output has increased by establishing re-integration into the work place only in the case of discriminatory or null and void dismissals, while for dismissals due to disciplinary reasons the reinstatement is provided only for specific cases which are still to be determined²⁰.

A new social safety net, Social Security Benefit for Employment (ASPI), is anticipated, which will be extended to workers with contracts for co-ordinated and continuous employment. ASPI beneficiaries should take action to find new employment by participating in training or re-training courses. The previous social safety net, the Redundancy Fund, will no longer be paid in event of termination of business or a branch of it.

In terms of active labour market policies, a National Agency for Employment is anticipated, involving the State, regions and autonomous provinces, under the vigilance of the Ministry of Labour. The Agency will not carry new burdens on public finance and will be responsible for co-ordinating the activities of the employment centres in addition to managing ASPI disbursements.

It is a reform inspired by flexicurity which has already inspired labour market interventions on the part of other countries in crisis such as Spain where labour market reforms commenced

¹⁹ See Senate Act n-148-B.

²⁰ In Italy, according to Art.18 of the Workers' Statute, paragraphs 1 and 2, dismissal is void when it occurs for the following reasons: marriage; violation of the prohibition of dismissal during pregnancy; use of parental leave; illicit motive (Art.1345 of the Civil Code).

in 2012 (Royal Decree Law 3/2012) and slowly, reduced Spanish unemployment to 23.67%, the lowest level since 2011²¹.

It is likely that, in Italy, the Jobs Act which has just been adopted will not be effective in the short-term but in the medium-term, at least in four years' time²².

The effectiveness of the reform, therefore, will greatly depend on the method and timing of the implementation of the decrees, and the expected presentation of the first Implementation Decree to the Cabinet in mid-December 2014 is certainly a positive sign.

The Commission considered that the reform could bring important benefits arising from the new logic of active and passive employment policies, but it is not certain that this assessment will be confirmed in the in-depth study of March 2015.

Equally positive is the assessment of the measures for the reduction of the tax burden which weighs on labour costs with disincentivising effects for new investments especially from foreign investors. In this sense, further measures have been provided for through the Stability Law for the year 2015 which, for new contracts with increased protection has provided businesses with total decontribution and deductibility of labour cost from taxes.

The effect in the short-term will be a reduction in revenue of approximately 4.5 billion which the Italian government believes that it should bear in order to try to stimulate employment.

Even in this case, therefore, it is a path that has just been opened, with respect to which the Commission has highlighted some risks associated with the late implementation of measures, such as the revision of the so-called fiscal expenditure and environmental tax. Both interventions are, in fact, aimed at a further reduction on employment tax.

Further observations voiced by the Commission are related to the lack of openness in the services market and network industries.

²¹ See Instituto nacional de estadística, Official data available at www.ine.es.

²² See C. Pissarides, *Labour Market adjustment: microeconomic foundations of short-run neoclassical and Keynesian dynamics* (1976); D.T. Mortensen, C.A Pissarides, *Job creation and Job destruction in the Theory of Unemployment*, 61 *Ox. J. Rev. Ec. St.* 397 (1994); more recently see the interview of A.Merli to C.Pissarides, *Bene la riforma ma i suoi effetti solo in quattro anni*, *IlSole24Ore*, 4th December, 2014.

It was particularly noted that the annual law for the market and competition, which should have taken the recommendations of the Anti-trust Authority for Competition and the Market (AGCM) into account, as provided by Law No. 99 of 2009, has never been adopted although some measures have been included in other laws.

The Commission has placed particular emphasis on the reform of local public services, and especially of local transport, a sector which particularly requires the introduction of more competition.

In fact, in local public services, a significant part of the market is still run on the basis of direct assignments entrusted to entities that do not always respect the necessary requirements of in-house providing. In many cases, the award of the service is done without notice and often the concession to operate is extended for more times.

The degree of liberalisation of the local public services sector is, therefore, still largely insufficient in terms of competition for market *access*. Moreover, even competition *within the* market is almost absent, with some exceptions.

It is necessary to proceed in the direction of progressive regularisation of service concessions that do not comply with European regulations.

In Italy, following an important ruling of the Constitutional Court dated 20th July, 2012, no. 199, a new standard for local public services was introduced (Art. 34, paragraphs 20 and 21, of Legislative Decree No. 179/2012, enacted into Law No. 221/2012), which obliged the competent authorities to change those management practices that do not comply with the requirements of European regulations by the 31st December, 2013 – the deadline was then extended to 31st December, 2014 (Legislative Decree No. 150/2013). By the same date, the Authorities have been obliged to publish a report that explains the reasons and the existence of the requirements pursuant to the European standards for the chosen form of service concession. The same report must include the specific contents of the obligations of the public and universal service, indicating the economic compensation if required.

The goal of the standard is to proceed to the “regularisation” of award-concessions in full acknowledgement of the total autonomy of the competent Authority in relation to the

choice of one of the three models of service management: service concessions awarded subject to tender; in-house providing; public-private partnership.

However, the effectiveness of the standard was poor to the point where the same AGCM highlighted the need to introduce instruments to verify compliance on the part of local Authorities.

In this perspective, the AGCM had proposed the introduction of a requirement for local Authorities not to submit a report but a determination, that is to say, an administrative act by which the official responsible for the entity's service *gives analytical reasons that justify the use of the chosen management model and highlights the benefits in terms of increased service efficiency resulting from this management model. This executive task should also illustrate the characteristics and the structure of the markets concerned, the operators present and highlight the existence of a benchmark cost for the provision of services.*

The need for an intervention aimed at improving competition has been highlighted by the Commission, especially in the local public transport sector which, in Italy, is characterised by an extremely complex regulatory framework. In this regard, a first step for the simplification of regulations and adaptation to Community legislation could lie in the provision of an Enabling Law for Government to strengthen the principle of competitive procedure for the award of services or otherwise encourage Authorities in the use of tenders for the selection of service providers. The Enabling Law could be passed by means of the annual bill for competition provided for by Law No. 99/2009, but to-date despite the report issued by the AGCM to that effect, a real path of reform has not yet been taken up.

6 The critical aspects relative to the institutional system

In general, the report pays particular attention to the institutional reform in place but the real weak point remains the ability to implement the reforms announced and partly initiated.

In particular, three types of problems came to be identified.

A first weakness is identified in the length of the legislative process due to our two-house system.

In this respect, the start of constitutional reform²³ is assessed positively.

Simultaneously, the legislative fragmentation resulting from the break-down of interventions in different legislative instruments has been negative. In particular, it was noted that the frequent recourse to legislative decrees favours the adoption of partial measures at the expense of organic structural reforms.

The result is a fragmentation and a stratification of standards that produce a high uncertainty in the regulatory framework, aggravated by delays in the adoption of implementation measures.

A second weakness relates to the overlapping of powers between the State and regions which reduces the effectiveness of the adopted standards. The problems arising from overlapping powers are accentuated by the lack of co-ordination in the division of responsibility between central and local public authorities, as well as the existence of many administrative rules and procedures at the local level.

According to the European Commission, the institutional weaknesses as discussed, should be addressed and resolved as a matter of priority to allow the reforms in economic matters to manifest their effects²⁴. The European Commission also considers that the re-organisation and rationalisation of the powers of the provinces, the reform of electoral law and the approval of constitutional reform currently under discussion, are useful for this purpose.

In this regard, it should be noted that in August 2014, the Senate approved the Bill of Constitutional Reform which overcomes the two-house system, reduces the number of Members of Parliament, the containment of operating costs of the

²³ See the text of the bill of constitutional reform which was approved at the first reading of the Senate (AS 1429) and currently before the House (Parliamentary Note 2613).

²⁴ See, World Economic Forum, *Global Competitiveness Report 2014-2015* cited by the Commission in the *Report on Review of Progress on Policy Measures Relevant for the Correction of Macroeconomic Imbalances*, according to which, Italy finds itself in the last position in the ranking of 144 countries with regard to transparency in policy-making decisions, the weight of public regulation, the efficiency of the legal system, favouritism in decisions of public officials and public confidence in politicians.

institutions, the abolition of the National Council of Economy and Labour (CNEL).

In particular, the constitutional reform provides for a differentiated two-house system, in which the House of Representatives becomes the exclusive holder of the relationship of trust with the Government. It will be the House of Representatives who will exercise the function of political, legislative and control on the actions of the government.²⁵

The other House, the Senate of the Republic, becomes a second-degree elected body, composed of a maximum number of one hundred members. Ninety-five senators are elected, proportionately by the regional councils and autonomous provinces. No region may have less than two senators. Five senators are nominated by the President of the Republic.

The Senate will also have to assume new tasks, such as: i) liaising between the European Union, the State and local entities; ii) the evaluation of public authority activities; iii) the verification of the implementation of the laws of the State; iv) the monitoring and evaluation of public policies; v) the provision of advice on Government appointments.

The legislative function will no longer be exercised equally by the two Houses with the exception of a narrow range of subjects. For all laws relating to other sectors, the role of the Senate is only advisory in nature because the final approval lies in the House of Representatives.

Moreover, in order to speed up the legislative process, a fast track for bills presented to Government has been provided for, which may request their review and approval within sixty days if considered to be essential for the implementation of the programme.

With reference to the overlap between the powers of the State and regions, the constitutional reform provides for the amendment of Title V of the Italian Constitution in accordance with some guidelines which overcome the rigid separation of lists of matters referred to in Art.117 Const.

²⁵ Constitutional reform was moved for the first reading in the House in December 2014; it is expected that subsequent readings in the Senate and in the House will take place by August 2015; the possible referendum and entering into force in February 2016.

It provides for a system for the division of legislative powers which is more flexible, and aspires for greater collaboration between State and Regions. The creation of the new division of legislative powers should, therefore, eliminate areas where there are concurrent legislative powers for the State and Regions, re-defining the exclusive powers of both levels of government. In order to avoid disputes, a “supremacy clause” has been introduced on the basis of the State Law which, on the proposal of Government, can intervene on matters or functions that are not within the legislative powers of the State, in which cases the protection of the legal and economic unity of the Republic is required or, in cases where it is necessary for the implementation of programmes, or of social-economic reforms that are of national interest.

In this regard, it should be noted that, in view of the long time required for the approval of constitutional reform, a comprehensive reform relative to local entities was approved (Law 56/2014). In particular, the reform which will commence on the 1st January, 2015, establishes metropolitan cities that will assume many of the powers which to-date were exercised by the Provinces, re-organises the Provincial system and encourages the union and merger of municipalities.

In this case also, a part of the reform is entrusted to future implementation decrees which shall regulate the functions effectively transferred to the metropolitan cities and the movement of personnel from one entity to another.

With specific reference to public administration, the report, while acknowledging the efforts put on place by the latest measures (in particular, Legislative Decree No. 69 of 2013 and No. 90 of 2014), maintains that the more ambitious steps may be introduced with the bill on the re-organisation of public administration currently under discussion in the Senate.

It is believed that the reform should allow Government to re-organise public administration even better, amongst others, with reference to the regulation related to public officials and the prevention of corruption²⁶.

²⁶ See Senate Act no. 1577 (Re-organisation of Public Authorities) currently being examined.

The re-organisation bill contains 10 mandates that allow Government to issue legislative decrees for implementation within 12 months from the approval of the law.

With regard to the re-organisation of the Authorities, Government is delegated to adopt legislative decrees for the achievement of two key objectives.

The first concerns the amendment of the structure of central offices and those territorial ministries and public entities which are not economically feasible in order to render these organisations simpler and leaner. This will imply a reduction in the Prefectures and a revision of their powers; the role of the Presidency of the Council of Ministers will be strengthened in the analysis and definition of public policies; offices in direct collaboration with the Minister will be reduced.

The second key point in the re-organisation of public administration relates to the reform of the structure of the Chambers of Commerce Industry Trade and Agriculture, in order to define functions and reform the funding system, eliminating the current obligatory contribution to businesses.

With reference to the management assessment, the law grants powers to Government to enact legislative decrees implementing the reform of general public management, including at the regional and local levels, as well as the management of the National Health Service. The decrees will, among other things, operate a simplified process of assessing the activities of officials and establish a connection between remuneration and results achieved.

With regard to anti-corruption measures, the bill in question provides that future legislative decrees should integrate and strengthen the current regulation already partly integrated by the Legislative Decree No. 90/2014 which expanded the tasks of the National Anti-Corruption Authority especially in the control of public procurement²⁷.

²⁷ The Law of 6th November, 2012, no. 190 had initially given the Commission for Assessment, Transparency and Integrity of public authorities the role of Anti-Corruption Authority; subsequently with Law 125/2013, converting Legislative Decree No. 101/2013, the Commission has assumed the title of National Anti-Corruption Authority and for the assessment and transparency of public authorities. Lately, Legislative Decree No. 90/2014, enacted into Law

It will certainly be taken into consideration that a weakness in the Italian system lies in the fact that the effective application of new measures is hampered by the inefficiency of the judicial system. It is a further area in which Government has already partly intervened (Legislative Decrees No. 138 of 2011, No. 69 of 2013, No. 90 and No. 132 of 2014) and in respect of which, has already launched a justice reform, both civil and penal, currently under discussion.

7. Conclusions. Flexibility in exchange for reliability

The analysis of the main measures taken by the Italian government to comply with the recommendations of the Council of June 2013 and the observations of the European Commission in November 2014 on the Update to DEF, allow for some reflections.

Last April, with the DEF 2014, Government decided to temporarily waive the adjustment path toward the Medium-Term Objective (MTO). The choice was, in fact, motivated by the presence of “exceptional circumstances”, identified with a distance of -3.7% on the product potential, much higher than the -2.7% threshold which the European Union considers to be representative of recessionary conditions.

At the same time, Government has reaffirmed its intent of not exceeding the limit of nominal deficit of 3% of GDP, the threshold originating from the Maastricht Treaty.

A debt reduction of 2.6% of GDP was expected and corrections equal to 0.3% of GDP in 2015 and 2016 have been announced. The elimination of the structural deficit has been postponed to 2016.

It was a plan inserted within a path for economic growth which provided for a product increment of 0.8% in the current year, 1.3% in 2015 and an average of 1.8% in 2016-2018. But these projections were not achieved.

In the 2014 Update, the Italian Government notes the failure to start the recovery process: a reduction of 0.3% of GDP and the output gap²⁸ exceeding 4% is provided for, a value which

No. 114/2014, has established that the Authority essentially focuses on matters of transparency and the prevention of corruption in public authorities.

²⁸ The output gap is the difference between actual GDP and potential GDP. Potential GDP represents the level of gross domestic product compatible with

indicates a state of severe recession due also to an unfavourable European and international economic climate.

In fact, the economic situation in the Eurozone has worsened over the months. In particular, the principle factor in the slow-down seems to be due to a reduction in exports. This trend is partly due to a downturn in demand from emerging economies and partly to decreases in importation in areas of greater political instability. In this sense, a significant impact stems from the fall of imports on the part of Russia.

International political events, such as the crisis in the Ukraine, also influence the expectations of businesses. This conditioning especially affects German industry which is highly integrated with countries from Eastern Europe.

Another negative element which weighs on national economic policy is low inflation in the Eurozone. Deflation might seem to be a favourable factor for the European economy in view of the reduction in international prices of raw materials. In reality, this instead represents a negative condition because it stems from the lowering of salary levels caused by high unemployment, the low market power of firms and from devaluation in different emerging countries.

In view of this international economic framework, the Italian government has aimed to modify its fiscal policy highlighting how exceptional events which allow a deviation from the path of fiscal consolidation, should not only include the low output gap, but also the deflation which causes an increase in the interest rates on debt.

In this perspective, the Update to the Economic and Financial Document (DEF) aims to outline an expansive manoeuvre to sustain economic growth for 2015 and not to make corrections to the dynamics of change in sales throughout 2016.

It is only in 2017 that the public finance adjustment points to a reduction in debt to ensure the structural budget balance.

It should be considered that the postponement of a balanced budget to 2017 requested by the Italian government was not simply a derogation from the rules, but was accompanied by a

full employment of production factors and with an unemployment rate consistent with price stability (Naiwru). See Mef, *Glossario di finanza pubblica* (2013).

launch of structural reforms aimed at removing old imbalances and boosting growth.

In fact, the launch of structural reforms is among one of the factors which, according to European and Italian regulation, can justify a temporary deviation from the adjustment path toward the MTO²⁹.

As previously described, the Italian financial manoeuvre has been divided into a series of structural reforms, including the reform of the PA, the reform of the labour market, the justice reform, some measures for competitiveness which should increase growth in the long-term. These reforms, in the Government's planned projections, should have positive effects on the growth of the GDP equal to 0.2 percentage points in 2016 and 0.4 percentage points in 2017 and 2018³⁰.

In this regard, a twofold uncertainty is noted in face of the Commission's in-depth analysis (*In Depth Review* – IDR) scheduled for March 2015.

The first is of a political nature and is related to the ability of the government and its parliamentary majority to adopt the implementing decrees of the different mandates in which the key structural reform points are contained.

On this aspect, the frequent disagreements within the government's political party (DP) and the agreements reached with the parties in opposition (Forza Italia) will have a bearing on reforms that are of vital importance for the country, first and foremost the electoral reform.

A second consideration is of an economic nature and is related to the estimation of the effects on growth and the time in which such effects can be achieved.

In this sense, for example, an element of uncertainty in respect to the improvement of public finances relating to the interventions on the labour market. As discussed, in fact, one of the factors in the Jobs Act is the elimination of contributions paid by firms for new contracts of employment.

²⁹ Reg. EC no.1466/97, art.5 “the implementation of major structural reforms which generate direct financial benefits in the long-term, including by raising potential sustainable growth, and which therefore have a quantifiable sustainability on public finances in the long-term”.

³⁰ See Mef, *Nota di aggiornamento al Def*, p.18, Tab.II.4 (2014).

The provision is designed in this way to stimulate the activation of indefinite contracts and reduce labour costs for businesses. However, some concerns relate to the difficult definition of those who may be the beneficiaries of these provisions even in consideration of the new potential employment contracts that could come into effect encouraged by the new regulation. The consequences on public finances resulting from lower income from contributions are, therefore, not ascertainable with any degree of certainty³¹.

In other words, it is not enough to start structural reforms, but it is necessary to carry them through in the shortest time possible and, above all, it is necessary for the effects of the structural reforms to be assessed in the long-term and not in the short-term³².

At the same time, it is necessary that Europe does not follow the route of rigorous orientation “at all costs”, just to achieve percentage adjustments of a few decimal places³³, but that it turns the route around to bet on new paths of growth. The possibility that this inversion is achieved depends largely on the reliability that governments undergoing strict monitoring for their macroeconomic imbalances, are able to demonstrate³⁴.

In fact, in view of the long lead times for the explanation of the effects expected from the reforms, it would be absurd if the Commission had to initiate an infringement procedure for excessive imbalances due to high debt or low competitiveness of the country. A possible initiation of infringement procedure would be counter-productive especially in view of the fact that the

³¹ See the Parliamentary Budget Office, *Rapporto sulla politica di bilancio 2015*, p.74-75, Rome, November 2014.

³² On these issues, see the broad analysis of A. Bassanetti, M. Bugamelli, S. Momigliano, R. Sabbatini and F.Zollino, *The policy response to macroeconomic and fiscal imbalances in Italy in the last fifteen years*, Banca d'Italia, Fiscal Policy and Macroeconomic Imbalances 445 (2014).

³³ The Head of the Eurogroup, J.Dijsselbloem, in the last meeting held on 8th December, 2014, highlighted the need for a correction of the structural deficit by 0.4 percentage points of GDP; in reality, this assessment did not take the further correction required by the Stability Law into consideration. See B. Romano, *Italia, necessarie misure efficaci*, *IlSole24ore*, 9th December, 2014.

³⁴ See M. Ferrera, *Legge di stabilità. Le virtù e i difetti nascosti*, *Corriere della sera*, 17 ottobre 2014.

actual reforms were initiated to represent a guarantee on the stability of public finances.

In the case of Italy, the possibility that the Commission concedes greater flexibility in view of exceptional events and structural reforms, does not depend so much on assessments of an economic nature but also on internal and supranational policy.

In relation to assessments of internal policy, as already discussed, a lot depends on the ability of the political class to work cohesively for the common interest.

With regard to the assessments of supranational policy, the European Commission's delicate position must be considered.

In fact, the Commission is forced to seek a compromise between the application of the rules of the Stability and Growth Pact on the one hand, and the political consequences that might ensue on the other.

In such a situation, recession is predictable and opening infringement procedures against France for excessive deficits or for excessive macroeconomic imbalances in the case of Italy, could trigger a political crisis threatening the integration process which has already been sorely tried.

It follows that so long as France remains firm in postponing deficit reduction policies to below 3%, Italy can take advantage of some flexibility, albeit conditional.

Moreover, the position taken by France and, though less dramatic, by Italy, as opposed to the German one, precisely confirms the main weaknesses of fiscal co-ordination applied in the absence of political union, or at least, of political co-ordination.

At the moment, the Eurozone portrays an image where each State is holding on to its position. The new European economic governance has reinforced procedures and objectives of fiscal co-ordination but is proving to be ineffective as a stimulus for the adoption of good practice by Member States³⁵.

In contrast, the strict application of the Pact has produced a slow-down in investment, fuelled unemployment and falling prices. All contrary effects to the objectives of stability originally placed in the same Pact for stability and growth.

³⁵ The doubts on the effectiveness of tax co-ordination also relate to the same Macroeconomic Imbalances Procedure; on this point see D. Gros and A. Giovannini, *The "Relative" Importance of EMU Macroeconomic Imbalances in the Macroeconomic Imbalance Procedure*, Document IAI 14 | 02 March 2014.

Compounding the picture is the loss of the concept of solidarity and the absence of a common vision (Tue, art.3, par.3) such that the required deficit reduction on the part of some countries (France, Italy, Belgium), can be balanced by a reduction of the budget surplus through an increase in investment by others (Germany).

In this context, the start of a process toward a political union seems more pressing.

Of course, this will entail reflecting on the contents of the political union and its method, community or inter-governmental; it will be necessary to revise the Treaties and perhaps, even hold a referendum on a European scale. Above all, the reflection must consider whether "the Monnet method" of European integration, based on a gradual approach through technocratic measures and economic integration is still valid.